

**IN THE  
SUPREME COURT OF MISSOURI**

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**No. 83888**

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**MEDICINE SHOPPE INTERNATIONAL, INC.,  
Appellant,**

**v.**

**DIRECTOR OF REVENUE,  
Respondent.**

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**On Petition for Review from the  
Missouri Administrative Hearing Commission  
Honorable Willard C. Reine, Commissioner**

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**BRIEF OF AMICUS CURIAE  
MISSOURI BANKERS ASSOCIATION**

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## **JURISDICTIONAL STATEMENT**

This appeal involves the construction of Section 143.451,<sup>1</sup> which is a revenue law of the State of Missouri. Accordingly, this Court has jurisdiction under Article V, Section 3 of the Missouri Constitution.

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<sup>1</sup> All statutory citations are to the Revised Statutes of Missouri of 2000, as amended, unless otherwise noted.

## **INTEREST OF THE AMICUS**

Missouri Bankers Association (“MBA”) is the umbrella Missouri banking organization representing almost all of Missouri’s commercial banks and additional depository institutions. Members of MBA include national and state-chartered banks, independent and holding company owned banks, and regional and community banks. Members of MBA hold approximately ninety-five percent of the Missouri assets of the Missouri commercial banking industry.

Out of about 360 commercial bank members of MBA, approximately 291 pay Missouri corporate income taxes. Some of these members elect to use the single factor method of apportionment set forth by Section 143.451.

In this case, the Director and Commission have asserted that income derived from loans of capital to entities operating wholly outside of Missouri constitutes Missouri source income under the single factor method of apportionment set forth by Section 143.451. The Director’s argument and the Commission’s decision have two apparent bases: first, that the introduction of unitary business concepts into the statutory single factor method of apportionment is appropriate, and second, that the particular facts of the Medicine Shoppe demonstrate that its labor within Missouri was the source of its interest and loan origination income.

MBA’s members provide capital for use wholly outside Missouri to non-Missouri entities. In negotiating and entering into agreements to provide this capital, MBA’s members rely upon the consistent interpretation of Missouri law, including Missouri taxation law. For more than half a century, MBA’s members have relied on this Court’s holdings in *Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942) and *Union Electric Company v. Coale*, 146 S.W.2d 631 (Mo. 1940), stating that the income derived from a loan of capital to a non-Missouri resident

borrower for use wholly outside of Missouri is not Missouri source income under the single factor method of apportionment set forth in Section 143.451. The Director's arguments and the Commission's decision in this case, if upheld by this Court, fundamentally alter the manner in which taxpayers electing the single factor method determine their Missouri taxable income, by introducing unitary business concepts to the statute-bound method. These arguments and the Commission's decision effectively modify the rules that have been applied in Missouri for more than half a century.

The Director's argument and the Commission's decision have created uncertainty with respect to the application of the single factor method of apportionment set forth by Section 143.451, and have therefore created uncertainty with respect to the reasonable expectations of Missouri tax law of MBA's members when they negotiate and enter into agreements to loan capital to out-of-state entities. Thus, MBA, on behalf of its members, has a direct interest in the outcome of this case and this Court's interpretation of the single factor method of apportionment set forth by Section 143.451.



## **STANDARD OF REVIEW**

The decision of the Commission shall be upheld only if: (1) it is authorized by law; (2) it is supported by competent and substantial evidence upon the whole record; (3) it violates no mandatory procedural safeguards; and (4) where the Commission has discretion, it exercises its authority in a way that is clearly not contrary to the Legislatures' reasonable expectations. Section 621.193. Only the first two standards are at issue in this case. Furthermore, this Court's interpretation of Missouri's revenue laws is *de novo*. *Zip Mail Services, Inc. v. Director of Revenue*, 16 S.W.3d 588, 590 (Mo. banc 2000). Last, taxing statutes, like the one before the Court in this appeal are strictly construed against the Director and in favor of the taxpayer. *Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942).

### **STATEMENT OF THE ISSUE**

In *Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942) and *Union Electric Company v. Coale*, 146 S.W.2d 631 (Mo. 1940), this Court held that income derived from a loan of money to a non-Missouri resident borrower for use wholly outside of Missouri was not Missouri source income under the single factor method of apportionment set forth in Section 143.451. Appellant loaned money to its out-of-state franchisees that used the money wholly outside of Missouri. Is Appellant's income from those loans Missouri source income under Section 143.451?

**POINT RELIED UPON**

**THE ADMINISTRATIVE HEARING COMMISSION ERRED IN DENYING APPELLANT’S CLAIM FOR REFUND AND AFFIRMING THE DIRECTOR’S ASSESSMENTS BECAUSE UNDER SECTIONS 621.189 AND 621.193 THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THE RECORD IN THAT APPELLANT’S INCOME DERIVED FROM LOANS OF MONEY TO NON-MISSOURI BORROWERS WHO USED THE SAME ENTIRELY OUTSIDE OF MISSOURI IS NOT MISSOURI SOURCE INCOME UNDER SECTION 143.451.**

*Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942);

*Union Electric Company v. Coale*, 146 S.W.2d 631 (Mo. 1940);

*Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983);

*A.P. Green Fire Brick Company v. State Tax Commission*, 277 S.W.2d 544 (Mo. 1955);

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*In re Kansas City Star Company*, 142 S.W.2d 1029 (Mo. 1939);

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*J.C. Nichols Company v. Director of Revenue*, 796 S.W.2d 16 (Mo. banc 1990);

*Lemay Building Corporation v. Director of Revenue*, 889 S.W.2d 835 (Mo. banc 1994);

*Luhr Bros., Inc. v. Director of Revenue*, 780 S.W.2d 55 (Mo. banc 1989);

*Maxland Development Corporation v. Director of Revenue*, 960 S.W.2d 503 (Mo. banc 1998);

*Philip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888 (Mo. banc 1988);

Section 32.200;

Section 143.451;

Section 143.451.2(2);

Section 143.451.2(2)(b);

Section 621.189;

Section 621.193.

## **ARGUMENT**

**THE ADMINISTRATIVE HEARING COMMISSION ERRED IN DENYING APPELLANT’S CLAIM FOR REFUND AND AFFIRMING THE DIRECTOR’S ASSESSMENTS BECAUSE UNDER SECTIONS 621.189 AND 621.193 THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THE RECORD IN THAT APPELLANT’S INCOME DERIVED FROM LOANS OF MONEY TO NON-MISSOURI BORROWERS WHO USED THE SAME ENTIRELY OUTSIDE OF MISSOURI IS NOT MISSOURI SOURCE INCOME UNDER SECTION 143.451.**

### **Introduction**

In *Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942) and *Union Electric Company v. Coale*, 146 S.W.2d 631 (Mo. 1940), this Court concluded that income derived from a loan of money used by a non-Missouri entity wholly outside of Missouri is not Missouri source income under Section 143.451. Appellant derived loan origination income and interest income by providing its capital to its out-of-state franchisees for use wholly outside Missouri. Appellant elected to use the single factor method of apportionment under Section 143.451. Therefore, as demonstrated below, Appellant’s loan origination income and interest income should not be treated as Missouri source income.

**I. Single Factor Apportionment is Not Subject to Unitary Business Concepts and Therefore Missouri has no Right to Tax Non-Missouri Source Income.**

Missouri law allows a corporation doing business within and without Missouri alternative methods to allocate and apportion its income for Missouri income taxation. First, a corporation may elect to use the single factor apportionment method of Section 143.451. Alternatively, a corporation may elect to use the Multistate Tax Compact formula under Section 32.200 to apportion its business income based upon the three-factor formula averaging property, payroll and sales ratios to derive its Missouri taxable income. Under that formula, non-business income is allocated under special rules. *See Philip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888, 889 (Mo. banc 1988); *Luhr Bros., Inc. v. Director of Revenue*, 780 S.W.2d 55, 57 (Mo. banc 1989). There is no dispute that Appellant timely elected the single factor apportionment method under Section 143.451 (L.F. 43). Likewise, single-factor apportionment under Section 143.451 does not embrace the distinction between business and non-business income that the Compact emphasizes.

In *Dow Chemical Company v. Director of Revenue*, 787 S.W.2d 276, 284 (Mo. banc 1990), this Court discussed the differences between the two apportionment methods. This Court concluded that the source of income test and its single factor method of apportionment were a complete and integrated system of apportionment, separate and apart from the Multistate Tax Compact (“Compact”) designation of business and nonbusiness income and its three-factor apportionment formula. *Id.*; *see also Goldberg v. State Tax Commission*, 639 S.W.2d 796 (Mo. banc 1982) (reaffirming the long-standing judicial interpretation of Section 143.451 as proper in determining issues regarding the source of income under the single factor method of apportionment).

The apportionment formula of the Compact functions on income of the unitary business, and therefore fairly apportions among the states income from all sources. *Dow Chemical*, 787 S.W.2d at 284. However, the source of income formula taxes only that income that results from transactions geographically sourced, in whole or in part, to Missouri. *Id*; *Maxland Development Corporation v. Director of Revenue*, 960 S.W.2d 503 (Mo. banc 1998). Therefore, the three factor apportionment method is not in *pari materia* with the source of income test set forth by Section 143.451. *Id*.

Because the methods are separate and distinct, the Commission erred in applying unitary business principles in apportioning income under Section 143.451. *Id*. Furthermore, under long-standing judicial interpretation of Section 143.451, income received from loaning money to non-Missouri borrowers for use wholly outside of Missouri is not Missouri source income. Because Appellant's loan origination and interest income was derived from loaning money to non-Missouri borrowers who used the money wholly outside of Missouri, this income is not Missouri source income and excluded from taxation.

## II. Appellant's Loan Origination and Interest Income Is Not Missouri Source

### Income under Section 143.451.

In *Petition of Union Electric Company of Missouri*, 161 S.W.2d 968 (Mo. 1942), this Court concluded that dividend income from shares of stock in corporations operating wholly outside of Missouri and interest income from a bond of a corporation operating entirely outside of Missouri did not constitute Missouri source income. This Court determined that there are three sources from which income can derive: labor; capital; and profits derived from the sale or exchange of capital assets. *Id.* at 970. Specifically, this Court found:

It is said that the locus of the source of income is determined as follows: In th[e] case of income derived from labor, it is the place where the labor is performed; in the case of income derived from use of capital; ***it is the place where the capital is employed***; and in the case of profits from the sale or exchange of capital assets, it is the place where the sale occurs.<sup>2</sup>

*Id.*, citing *In re Kansas City Star Company*, 142 S.W.2d 1029 (Mo. 1939).

With respect to the dividend income, this Court noted that the actual use of the capital that gave rise to the income represented by these dividends took place outside

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<sup>2</sup> Emphasis added here and throughout, unless otherwise noted.



Missouri. Specifically, this Court stated:

We are forced to the conclusion therefore that the source of this income was outside the state and the dividends received by the taxpayer should not be included in its gross income for the purpose of computing its Missouri income tax.

*Id.* at 971.

***This Court similarly concluded that the interest income was not Missouri source income:***

The nature and characteristics of interest payments cannot be changed by the fact that the debt upon which such interest is paid is evidenced by a bond. . . .

The basic facts are these: That the taxpayer lent money to a person in another state which was used by that person in the other state and that the taxpayer, as an incident to such loan, was paid interest. . . . We think that the source of the [interest] income is the person paying the interest and not the mere bond itself, which is only an evidence of the indebtedness. ***It therefore follows that the interest payments must be treated in the same manner as the dividend payments, and what we have said in regard to dividends will largely apply to interest.***

*Id.* at 971-72.

This Court has consistently followed its holding in *Petition of Union Electric* that income earned from the use of capital outside of Missouri is not Missouri source income, and therefore not

subject to apportionment under the single factor method of Section 143.451. *See, e.g., Union Electric Company v. Coale*, 146 S.W.2d 631 (Mo. 1940) (dividend income received from companies operating exclusively outside Missouri was not Missouri source income); *A.P. Green Fire Brick Company v. State Tax Commission*, 277 S.W.2d 544 (Mo. 1955) (royalty income paid by foreign corporation for use of Missouri corporation's trademarks, tradenames and manufacturing processes is not Missouri source income and not subject to single factor apportionment because income was derived from activities outside Missouri); *Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983) (royalty income earned by Missouri corporation for use of Missouri corporation's tradenames, shoe designs and shoe patterns is not Missouri source income and not subject to single factor apportionment because income was derived from activities outside Missouri).

In this case, Appellant loaned money to its out-of-state franchisees for use exclusively outside of Missouri. The out-of-state franchisees used Appellant's capital exclusively outside of Missouri. Appellant's loan origination income and interest income was derived solely through the use of this capital outside of Missouri. Therefore, under this Court's long-standing interpretations of the source of income rules, Appellant's loan origination and interest income is not Missouri source income subject to tax under Section 143.451.

### **III. The Commission's Basis for Treating Appellant's Loan Origination Income and Interest Income as Missouri Source Income Is Inconsistent with Section 143.451.**

The Commission apparently understood that if this Court's decisions in *Petition of Union Electric Company*, *Union Electric Company v. Coale* and *A.P. Green* apply, Appellant's loan origination and interest income were not Missouri source income and thus not subject to apportionment under the single factor method set forth by Section 143.451 (L.F. 52-53):

The extent of [Appellant's] Missouri efforts is readily distinguishable from the mere receiving of interest and dividends on stocks and bonds as decided in *Petition of Union Electric Co.*, the receiving of royalties in *A.P. Green*, or the receiving of dividends from stock in foreign corporations in *Union Electric v. Coale*.

However, as discussed below, none of the bases the Commission articulated in its decision (or the Director in her arguments before the Commission) justify its departure from this Court's long-standing interpretation of the source of income rules.

#### **A. Section 143.451.2(2) Does Not Affect the Source of Income Rules**

Before the Commission, the Director argued that the formula for the single factor apportionment under Section 143.451.2(2)(b) requires that all income (including non-Missouri source income) is subject to single factor apportionment. Section 143.451.2(2)(b) provides:

[T]he amount of business transacted wholly in this state shall be added to one-half of the business transacted partly within this state and partly without this state, and the amount thus obtained shall be divided by the total amount of

business transacted, and the *net income* shall be multiplied by the fraction thus obtained, to determine the proportion of income to be used to arrive at the amount of Missouri taxable income. . . .

This Court rejected that argument, most recently and directly in *Brown Group, Inc. v. Administrative Hearing Commission*, 649 S.W.2d 874 (Mo. banc 1983):

So too, in subsection 1 of § 143.451, a tax is imposed which includes all income derived from sources within this state. Therefore, the Director's argument that § 143.451.2(2)(b) extends to tax income from all sources because it uses the term "net income" without qualification cannot be accepted in light of those provisions which restrict taxation of a corporation's income to that derived from sources within this state.

*Id.* at 879-80. *See also A.P. Green Fire Brick Company v. State Tax Commission*, 277 S.W.2d 544 (Mo. 1955) (holding that non-Missouri source income is excluded from the apportionment factor set forth by Section 143.451.(2)(b) pursuant to this Court's transcript, Exhibit B and Exhibit C.). Therefore, this Court should likewise reject the argument in this case.

**B. The Commission's Application of Unitary Business Concepts to this Case Was Inappropriate.**

In justifying its decision that Appellant's loan origination income and interest income constituted Missouri source income under Section 143.451, the Commission stated (L.F. 53):

It is clear from the record as a whole that Medicine Shoppe's operation in Missouri is an integrated operation in that everyone contributes to obtaining the franchisees that generate the income. Further, the fact that the source of funds

is excess cash of Medicine Shoppe does not diminish the fact that the company's activities from its Missouri headquarters contribute directly to the income that is produced by the financing. Financing the franchisees is part of its business operation, just as acquiring franchise fees is part of the business operation.

As noted above, the apportionment formula of the Compact functions on income of the unitary business, and therefore includes income from extraterritorial sources and other entities to derive the Missouri tax base. *Dow Chemical*, 787 S.W.2d at 284. The source of income test includes only income from geographical transactions in deriving the Missouri tax base. *Id.* Therefore, the three factor apportionment method is not in *pari materia* with the source of income test set forth by Section 143.451. *Id.* Because the methods are separate and distinct, the Commission's application of unitary business principles to Appellant's loan origination income and interest income was inappropriate.

**C. The Source of Income Cases Cited by the Director Do Not Support Her Position.**

The Director cited several of this Court's decisions in an attempt to distinguish Appellant's income from the rules set forth by this Court in *Petition of Union Electric Company*, *Union Electric Company v. Coale* and *A.P. Green*. However, because none of these cases contradict this Court's holdings in those cases, the Director's attempts to use these cases to depart from this Court's long-standing interpretation of the source of income rules should be rejected.

The Director first cited *J.C. Nichols Company v. Director of Revenue*, 796 S.W.2d 16 (Mo. banc 1990). In that case, this Court determined that a corporation's development, management and sale of real estate located in Kansas from its Missouri headquarters constituted income from

sources partly within and partly without Missouri. This court, consistent with the holdings in *Petition of Union Electric Company, Union Electric Company v. Coale* and *A.P. Green*, stated that the “source of income” is the place where income is produced. However, *J.C. Nichols* was different from these cases in that the income was derived through the use of **labor** (*i.e.*, the active management and decision-making surrounding the real estate). In this case, Appellant’s loan origination income and interest income was derived through the use of Appellant’s **capital** by the out-of-state franchisees outside Missouri. Thus, contrary to the Director’s insinuations to the contrary before the Commission, Appellant’s position is consistent with *J.C. Nichols*; it is the Director’s interpretation of the case that is contrary to Missouri law.

Likewise, the other cases cited by the Director provide no support for her position. In *Bank Building and Equipment Corporation of America v. Director of Revenue*, 687 S.W.2d 168 (Mo. banc 1985), this Court held that a construction company’s consulting, design and construction of buildings outside Missouri constituted income derived from sources partly within and partly without Missouri because the labor creating this income was, at least in part, expended from the taxpayer’s Missouri headquarters. *See also Hayes Drilling v. Director of Revenue*, 704 S.W.2d 232 (Mo. banc 1986) (income from drilling projects conducted outside Missouri were from sources partly within and partly without when labor was expended from Missouri headquarters in connection with the drilling income); *Lemay Building Corporation v. Director of Revenue*, 889 S.W.2d 835 (Mo. banc 1994) (income from management of mobile home park in Florida was derived from sources partly within and partly without Missouri when Missouri headquarters used labor to manage the mobile home park’s operation).

Finally, the Director's cited *Maxland Development Corporation v. Director of Revenue*, 960 S.W.2d 503 (Mo. banc 1998), but that case actually demonstrates that Appellant was correct in treating its loan origination income and interest income as non-Missouri source income. The *Maxland* case involved three appeals in which corporations headquartered in Missouri owned a fractional interest in a shopping center located outside of Missouri. In two of the cases, this Court held that the use of labor from the Missouri headquarters for managing the corporation's interest in the shopping center made all such income derived from sources partly within and partly without Missouri. *Id.* at 506. In the third case, the one involving a Michigan shopping center, the corporation owned its interest as a triple net lease, whereby the lessee paid all of the expenses, including maintenance, insurance, taxes and utilities. Because this corporation was not expending labor in producing its income under the triple net lease, this Court held that this income was not Missouri source income. *Id.* at 507.

Before the Commission, the Director argued that the following facts demonstrated that Appellant's labor expended in Missouri was productive of Appellant's loan origination and interest income:

- (1) Appellant's decision to commit excess cash for investment was made in Missouri;
- (2) Appellant's decision to solicit loans to its out-of-state franchisees was made in Missouri;
- (3) Appellant's credit review of its borrowers and determination whether to make a particular loan was made in Missouri;
- (4) The determination of the amount of capital to be loaned to a particular franchisee was made in Missouri;

- (5) The disbursement of the loan proceeds to the franchisee occurred in Missouri;
- (6) Appellant administered its outstanding accounts from Missouri; and
- (7) Appellant took a security interest in the franchisee's property located outside Missouri.

Neither the Director nor the Commission explained how any of these facts distinguished Appellant's situation from the "basic facts" set forth in *Petition of Union Electric Company of Missouri*, 161 S.W.2d at 971-72 that "[Appellant] lent money to a person in another state which was used by that person in the other state and that the taxpayer, as an incident to such loan, was paid interest." Indeed, although not stated in this Court's opinion (presumably, because it was not relevant to this Court's decision), Union Electric, as a prudent investor, from its Missouri headquarters must have decided to:

- (1) invest its excess cash on hand;
- (2) solicit investments for its excess cash;
- (3) review its potential investments, including conducting studies to ensure that its investment would generate a positive return;
- (4) determine the amount of cash to be invested;
- (5) disburse the investment proceeds to the place of the investment; and
- (6) monitor the investment account to ensure that the agreed-upon return on the investment is actually paid.

Neither the Director in her arguments before the Commission nor the Commission in its decision were able to distinguish Appellant's situation from that of *Petition of Union Electric Company*,



*Union Electric Company v. Coale* or *A.P. Green*, other than by reference to unitary business concepts. Therefore, because Appellant's facts are the same "basic facts" as the facts in these cases, Amicus respectfully submits that this Court follow its long-standing judicial interpretation of the source of income rules under the single factor method of apportionment set forth by Section 143.451, and determine that Appellant's loan origination income and interest income are not Missouri source income subject to Missouri apportionment. Further, to the extent this Court determines that the facts in this case distinguish Appellant's situation from those in *Petition of Union Electric Company, Union Electric Company v. Coale* or *A.P. Green*, Amicus respectfully requests that such factual distinctions be made apparent in this Court's opinion for application to different factual situations.

### **CONCLUSION**

For the foregoing reasons, this Court should reverse the decision of the Commission and determine that Appellant's loan origination income and interest income does not constitute Missouri source income under the single factor method of apportionment set forth by Section 143.451.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that two true and accurate copies of the foregoing were mailed first class, postage prepaid, this 25th day of October 2001, to Assistant Attorney General James Layton, P.O. Box 899, Jefferson City, Missouri 65102 and to Richard E. Lenza, Shughart Thomson & Kilroy, P.C., 120 West 12th Street, Kansas City, Missouri 64105, Attorneys for Appellant.

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**CERTIFICATE REQUIRED BY SPECIAL RULE 1(C)**

I hereby certify that the foregoing brief includes the information required by Supreme Court Rule 55.03 and complies with the limitations contained in Supreme Court Special Rule 1(b). The foregoing brief contains 4,754 words.

The undersigned further certifies that the disk simultaneously filed with the briefs filed with this Court under Supreme Court Rule 84.05(a) has been scanned for viruses and is virus-free.